

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
EQUITY REAL ESTATE APPRAISAL AND VALUATION**

April 15, 2002

This Policy is effective immediately upon adoption and supersedes all previous real estate appraisal policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Appraisal and Valuation ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and returns associated with this segment of the markets.

II. STRATEGIC OBJECTIVE

The System shall regularly monitor its individual asset and portfolio investment performance against pro forma, industry benchmarks, and adopted objectives and policies. The Staff shall receive assistance in measuring and verifying asset performance annually through an independent appraisal of market value for each investment in the Core Equity Real Estate Portfolio. The Staff, at their discretion, shall schedule appraisals within a given year, occurring on a rolling four-quarter basis. The Real Estate Appraisal Review and Performance Reporting Program shall select appraisers appropriate to perform valuations on the real estate investments.

III. INVESTMENT APPROACHES AND PARAMETERS

A. Appraisal Policy

1. Appraisals shall conform with the Uniform Standards of Professional Appraisal Practice (USPAP) of the Appraisal Foundation. Accordingly, the appraisals shall provide a market value estimate of the System's specific interest in real estate assets. Market value should be based on the

USPAP definition; therefore market value should reflect the most probable selling price for the System's interest given a reasonable exposure period, and assuming a willing and knowledgeable buyer and seller.

2. The System's interests may include 100% owned, partial interests, joint ventures, general or limited partner interests, mortgagor or mortgagee, ground lessor, or some form of participating debt.
3. The System's interest should be valued on an unleveraged basis, unless such leverage is considered favorable (below market) and would be assumable by the purchaser.
4. An appraisal of the market value of the System's interests should consider the depth, or lack thereof, of a market for that type of interest, the profile of the most likely buyers, and an understanding of how these interests are priced in the relevant market. If appropriate, premiums or discounts should be analyzed and supported which address issues such as control, marketability, minority or majority interests, right of first refusal, purchase options, preferred returns, and so forth. Market participant interviews and published survey data shall support appropriate rates of return.
5. Certain properties may be exempt from the process under the following conditions and at the Staff's discretion:
 - a. Property with a very low risk profile (e.g., single tenant supermarkets).
 - b. Property marketed for sale or under contract for sale.
 - c. Property held for less than one year.
6. Reputable firms, utilizing staff who are Members of the Appraisal Institute (MAI designation), shall be engaged to prepare the appraisals. Property assignments shall be rotated every five years or earlier depending on the quality of service and product, or other situations indicating a prudent change should occur. Rotation also gives the System a new perspective in the market, as well as preventing any appraisal firm from becoming too dependent on past market assumptions and valuations. The System's Staff Procedures Manual shall contain criteria for selection of appraisers.

B. Valuation Policy

1. The System shall report the market value as indicated in the System's most recent appraisal or as determined through the appraisal process outlined below.
2. The System shall use the Appraisal Arbitration Process outlined within this section in settling valuation disputes at the end of a contract period.
3. The appraisal process will follow the succeeding steps:
 - a. The System will engage an appraisal firm for completing an appraisal of the property at the termination of the contract period.
 - b. Upon review of the appraisal, either the System or the Investment Manager may initiate the following appraisal arbitration process.

Appraisal Arbitration Process

- 1) Either the System or the Investment Manager(s), at their own expense, may obtain a second appraisal using an appraiser from the System's approved list of appraisers. The election to obtain another appraisal must be made within 15 days of the event triggering the determination of the Project's fair market value.
- 2) If the second appraisal does not differ from the System's initial appraisal by more than 5%, then the average of the two appraisals shall be considered the market value of the property.
- 3) If the second appraisal differs by more than 5% from the System's initial appraisal, the two appraisers who prepared the appraisals shall meet and determine the market value of the property. If the two appraisers cannot agree upon a value within 30 days of the date of the last appraisal, they shall select a third appraiser from the list of the System's approved appraisers within 30 days of the date of the last appraisal.

- 4) If the appraisers cannot agree on the market value, they shall select a third appraiser from the Approved List to perform a third appraisal. An average of the three appraisals shall be considered the market value of the property. If, however, the lowest appraisal or the highest appraisal or both differ by more than 5% from the middle appraisal, then such low or high or both appraisals shall be disregarded. The average of the remaining appraisals or the remaining appraisal, if both are disregarded, shall be considered the market value of the property. Both Investment Managers shall share equally the expense of the third appraisal.
- c. If upon termination of the initial contract period, the current contract shall not be renewed and therefore the property shall be transferred to new management, the following additional process shall also be employed.

Initial Valuation at the Beginning of an Investment Management Relationship

The new manager shall review the appraised value of the property as determined above in Section III.B.3.b. If the new advisor agrees with this value, no further action is necessary and this value becomes the beginning value for the purposes of the new contract. However, if the new manager or the System disagrees with the new value, they shall follow the succeeding process:

- 1) The System shall instruct the outgoing Manager(s) to market the property for sale using a third-party brokerage firm to broadly solicit offers (“Market Offers”) from the market.
- 2) The new Investment Manager shall submit a value (“New Manager Bid”) for the property to the System. The System shall not share the New Manager Bid with the outgoing manager.
- 3) The System shall determine its own bid (“Hold Value”), which is the value that it would

continue to hold the asset as an investment (and not sell below).

- 4) Upon completion of the marketing process, the System shall compare the Market Offer, the New Manager Bid, and its Hold Value.
- 5) If the highest value among these three values is the New Manager Bid, the System shall retain its ownership of the asset and transfer the management of the asset to the new Investment Manager. The value of the asset will equal the New Manager Bid for the purposes of both the final valuation of the outgoing manager and the initial valuation for the new manager.
- 6) If the Market Offer, based on the estimated net sales proceeds, is the highest of these three values, the System shall instruct the outgoing manager to complete the sale of the asset. Thus the final net proceeds of sale determines the final value in the outgoing manager's contract.
- 7) If the System's Hold Value is the highest of these three values, the System shall retain the asset and arrange for the management of the asset at its own discretion. The value of the asset in this instance shall equal the appraised value of the asset.

C. Specialized Portfolio

This appraisal policy shall apply to Core and Non-Core Equity Real Estate Portfolios, if applicable, that may require fair market valuations as defined by the Uniform Standards of Professional Practice (USPAP) of the Appraisal Institute.